

Decision **PROPOSED DECISION OF ALJ BEMESDERFER** (Mailed 2/12/2016)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of SOUTHERN CALIFORNIA EDISON COMPANY (U338E), a California Corporation, and the CITY OF LANCASTER, a California Municipal Corporation, for an Order Authorizing the Sale and Conveyance of Certain Electric Streetlight Facilities Pursuant to Public Utilities Code Section 851.

Application 15-04-001  
(April 1, 2015)

**DECISION AUTHORIZING SALE OF ELECTRIC STREETLIGHT FACILITIES**

**Summary**

We authorize the sale by Southern California Edison Company (SCE) of certain electric streetlight facilities (Streetlight System) to the City of Lancaster (Lancaster) pursuant to Public Utilities Code Section 851. We order that the entire gain on sale of the facilities shall be allocated to the shareholders of SCE. The proceeding is closed.

**1. Procedural History**

SCE and Lancaster jointly filed this application on April 1, 2015, for authorization to sell the Streetlight System to the city. The application stated that the proposed sale price of \$11,790,000 would result in a pre-tax gain on sale of \$1,811,368, representing the difference between the sale price and the net book value of the Streetlight System, and an after-tax gain on sale of \$569,114. On May 4, 2015, the Office of Ratepayer Advocates (ORA) filed a timely protest to the application. On May 14, 2015, SCE filed a reply to the ORA protest. A

prehearing conference was held on August 18, 2015 at which the parties agreed that the sole disputed issue is the allocation of the gain on sale of the Streetlight System. The presiding Administrative Law Judge (ALJ) ordered the parties to brief the issue and that the matter would be deemed submitted for decision upon receipt of the briefs. Pursuant to the ALJ's order, ORA filed and served its opening brief on October 23, 2015 and SCE and Lancaster filed and served their joint reply brief on November 6, 2015.

## **2. Discussion**

The joint applicants seek Commission approval under Public Utilities Code § 851 of the sale of the Streetlight System to Lancaster. "The primary question for the Commission in § 851 proceedings is whether the proposed transaction serves the public interest: The public interest is served when utility property is used for other productive purposes without interfering with the utility's operation or affecting service to utility customers."<sup>1</sup> Joint applicants assert that this transaction serves the public interest in that after the sale, Lancaster will continue to make productive use of the Streetlight System while realizing a lower overall cost to operate and maintain it.<sup>2</sup> Moreover, there is no reason to believe that SCE's utility operation or ability to service its customers will be negatively affected after the sale. Though ORA protests the Application, it does not contend that the sale of the Streetlight System to Lancaster is not in the public interest. Nor does ORA object to the sale price or to the terms of the

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<sup>1</sup> Application of San Diego Gas & Electric Company (U902E) for Approval Pursuant to Pub. Util. Code § 851 to Lease Transfer Capability Rights to Citizens Energy Corp., D.11-05-048 (2011) at 7 (quoting D.09-04-013) ("SDG&E 851 Decision").

<sup>2</sup> Application at 3.

Purchase and Sale Agreement. ORA's sole objection is to the Applicants' proposal to allocate the entire gain on sale to the shareholders of SCE. We reject ORA's protest and approve the sale, including the allocation of the entire gain on sale to the shareholders of SCE.

The Commission's Redding II decision<sup>3</sup> sets forth the standard for when the gain on sale of a utility's distribution system, such as the streetlights at issue here, accrues to shareholders, rather than to customers. The factual circumstances under which the gain on sale accrues to shareholders are:

- a) A distribution system of a public utility (i.e., gas, electric, or water utility) is sold to a municipality or some other public or governmental entity, such as a special utility district;
- b) The distribution system consists of part or all of the utility operating system located within a geographically defined area;
- c) The components of the system are or have been included in the rate base of the utility; and
- d) The sale of the system is concurrent with the utility being relieved of, and the municipality or other agency assuming, the public utility obligations to the customers within the area served by the system.<sup>4</sup>

ORA does not dispute that SCE's sale of the Streetlight System to Lancaster meets these basic requirements of Redding II. Rather, ORA disputes whether the following two additional requirements of Redding II are met:

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<sup>3</sup> Ratemaking Treatment of Capital Gains Derived from the Sale of a Public Utility Distribution System Serving an Area Annexed by a Municipality or Public Entity, 32 CPUC 2d 233, D.89-07-016 (1989), *aff'd*, D.06-05-041 (Redding II).

<sup>4</sup> *Id.*

- a) The remaining ratepayers on the selling utility's system are not adversely affected, and
- b) The ratepayers have not contributed capital to the distribution system.<sup>5</sup>

For the reasons set out below, we find that the sale of the Streetlight System to Lancaster also meets these two requirements.

**A. Rate Subsidies Are Not Capital Contributions.**

ORA's arguments that the gain on sale should go to customers misconstrue the Redding II decision. Redding II makes clear that a utility's gains or losses resulting from the sale of a distribution system to a municipality accrue solely to shareholders, provided that customers did not contribute capital to the distribution system. ORA attempts to get around this plain rule by claiming that customers here actually made capital contributions to the Streetlight System because, due to rate subsidies, "customers benefiting from the Streetlight Facilities do not pay the full costs of such services." ORA then reasons that the rate subsidy "burden" imposed on customers who pay more than their "fair share" of "costs of owning, operating, and maintaining the Streetlight Facilities . . . amounts to a capital contribution."<sup>6</sup>

ORA's conclusion is contrary to well-established case law and Commission practice in at least three ways:

First, courts have long held "that '[b]y paying bills for service [utility customers] do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the

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<sup>5</sup> *Id.*

<sup>6</sup> ORA Brief at 6.

company.’ Rather, ‘[c]ustomers pay for service, not for the property used to render it.’ The revenue paid by the customers belongs to the company.”<sup>7</sup> The Commission, too, has “explicitly rejected the notion that ratepayers hold legal title to utility property by virtue of bearing costs associated with utility property, including carrying costs.”<sup>8</sup>

United States Supreme Court Justice Thurgood Marshall explained the basis for this fundamental concept in a 1986 concurring opinion involving Pacific Gas and Electric Company (PG&E):

[A] consumer who purchases food in a grocery store is “paying” for the store’s rent, heat, electricity, wages, etc., but no one would seriously argue that the consumer thereby acquires a property interest in the store. That the utility passes on its overhead costs to ratepayers at a rate fixed by law rather than the market cannot affect the utility’s ownership of its property, nor its right to use that property for expressive purposes. The State could have concluded that the public interest would be best served by state ownership of utilities. Having chosen to keep utilities in private hands, however, the State may not arbitrarily appropriate property for the use of third parties by stating that the public has “paid” for the property by paying utility bills.<sup>9</sup>

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<sup>7</sup> *Ponderosa Tel. Co. v. Pub. Utils. Comm’n*, 197 Cal. App. 4th 48, 57 (2011) (quoting *Bd. of Comm’rs v. N.Y. Tel. Co.*, 271 U.S. 23 (1926)).

<sup>8</sup> *Redding II* (supra) (citing OIR for the Purpose of Considering Policies & Guidelines Regarding the Allocation of Gains from Sales of Energy, Telecomms. & Water Util. Assets, D.06-05-041 (2006), modified by D.06-12-043).

<sup>9</sup> *Pac. Gas & Elec. Co. v. Pub. Utils. Comm’n*, 475 U.S. 1, 23 n.1 (1986) (Marshall, J., concurring) (emphasis added; internal citation omitted).

Likewise, customers who may have subsidized a portion of the Lancaster streetlight system were not making capital contributions and have no ownership interest in the streetlights merely because they paid their electric bills.

Second, while ORA implies that SCE created “inequities” in the rate structure and should therefore pay the gain on sale to customers to make them “whole,”<sup>10</sup> it is the Commission -- not SCE -- that decides which customers pay which rates. “The setting of utility rates and rates of return is a legislative act, delegated by the Legislature to the Public Utilities Commission.”<sup>11</sup>

The Commission “determines for a test period the utility expense, the utility rate base, and the rate of return to be allowed. Using those figures, the commission determines the revenue requirement, and then fixes the rates for the consumers to produce sufficient income to meet the revenue requirement.”<sup>12</sup> Moreover, when determining which customers will pay which rates to generate sufficient revenue to meet SCE’s Commission-approved revenue requirement, the Commission balances several equitable factors, including “fair apportionment of cost of service” and “customer acceptance.”<sup>13</sup> Thus, the Commission already considered the myriad equities when deciding to set rates for streetlights. It is therefore unnecessary (and not required by Redding II) to balance the equities again when deciding who should receive the gain-on-sale from SCE’s sale of the Streetlight System to Lancaster.

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<sup>10</sup> ORA Brief at 7-8.

<sup>11</sup> *S. Cal. Gas Co. v. Pub. Utils. Comm’n*, 23 Cal. 3d 470, 480 (1979).

<sup>12</sup> *Farrington v. Citizens Utils. Co.*, 27 CPUC 2d 308, D.88-01-050 at 15 (1988).

<sup>13</sup> *Id.* at 16-17. (*emphasis added*).

Third, ORA's argument incorrectly assumes that the Commission was unaware of rate subsidies when it decided Redding II. But rate subsidies were part of the rate structure of electric utilities long before Redding II was decided. The Commission does not set rates based solely on marginal cost. Instead, the Commission balances several factors besides cost-of-service when setting rates such as:

- Production of the revenue requirement;
- Simplicity and ease of understanding;
- Stability of revenue;
- Fair apportionment of the cost of service;
- Discouragement of wasteful use; and
- Encouragement of efficient operation of the system.

In the attempt to design rates possessing these attributes, various factors are usually considered, including:

- Cost of service;
- Historical rate structure;
- Competitive conditions;
- Value of service;
- Adequacy of service; and
- Customer acceptance.<sup>14</sup>

The Commission knew this in 2006 when it decided Redding II and could not have intended in Redding II that such rate subsidies constitute capital contributions when analyzing sales of distribution systems (or in this case, streetlight assets) to municipalities. Otherwise, the Redding II rule would never apply; every sale of a distribution system to a municipality inevitably implicates

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<sup>14</sup> *Farrington*, D.88-01-050 (quoting *In re PG&E*, D. 84902, 78 CPUC 638 (1975)).

rates that reflect some degree of inherent subsidies sanctioned by the Commission.

**B. SCE's Customers Will Not be Adversely Impacted by the Sale of the Streetlight System to Lancaster.**

ORA also argues that Redding II's requirement that "the remaining ratepayers on the selling utility's system are not adversely affected" means that customers who have subsidized the costs of operating the Lancaster streetlights and "who are receiving no benefits from the Streetlight Facilities" must "be made whole (i.e., by mitigating the adverse impacts)."<sup>15</sup> This argument fails for two reasons.

First, ORA's argument misconstrues Redding II. The "no adverse impact on existing ratepayers" requirement does not stand for the proposition that customers should be "made whole" for subsidizing the cost of streetlights. Rather, the Commission explained in Redding II that "no adverse impact" means that the streetlight transfer should not affect the cost or quality of service to remaining ratepayers:

"We note that we have always allocated to shareholders the gains or losses from the total liquidation of a public utility. The transfer of distribution facilities together with the assumption of the responsibility to serve customers is essentially a partial liquidation of the public utility which transfers the facilities. Thus, the rules on liquidation logically should cover the narrowly defined circumstances we have described. However, we make one exception, when the transferring utility continues to serve those of its ratepayers that are not served by the transferred distribution system. Where the transfer is shown to have an adverse impact on cost

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<sup>15</sup> ORA Brief at 8.



or quality of service to the remaining ratepayers, we will change the allocation to the extent necessary to mitigate such impact.<sup>16</sup>

There is no reason to believe — and ORA does not suggest — that cost or quality of service to SCE’s customers will be adversely affected after transferring the Streetlight System to Lancaster.

### **Categorization and Need for Hearing**

In Resolution ALJ 176-3555 adopted April 9, 2015, this proceeding was preliminarily categorized as ratesetting and it was preliminarily determined that hearings were required. We confirm the ratesetting categorization and change the hearing determination to “not required.”

### **Comments on Proposed Decision**

The proposed decision of ALJ Bemederfer in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission’s Rules of Practice and Procedure. No comments were filed.

### **Assignment of Proceeding**

Liane Randolph is the Assigned Commissioner and Karl J. Bemederfer is the Assigned Administrative Law Judge in this proceeding.

### **Findings of Fact**

1. The sale price of the Streetlight System is \$11,790,000.
2. The net book value of the Streetlight System is \$9,978,632.
3. The pre-tax gain on sale \$1,811,368.
4. The after-tax gain on sale is \$569,114.

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<sup>16</sup> Redding II, 32 CPUC 2d 233, 235.

**Conclusion of Law**

1. For the foregoing reasons, we conclude that all requirements of Redding II have been met in the proposed sale of the Streetlight System to Lancaster, the transaction should be approved and all gain on sale assigned to the shareholders of SCE.

**O R D E R**

**IT IS ORDERED** that:

1. The proposed sale of the Streetlight System is approved.
2. All gain on sale generated by the sale of the Streetlight System is allocated to the shareholders of Southern California Edison Company.
3. The comment period for today's decision is not waived.
4. Hearings are not required.
5. Application 15-04-001 is closed.

This order is effective today.

Dated \_\_\_\_\_, 2016, at San Francisco, California.